market more quickly than we anticipated. Finally, we note the impending entry of alternative providers of mobile telephone services such as so-called specialized mobile radio carriers and personal communications services. All of these factors lead us to conclude that our regulation of the marketplace for mobile communications will require further examination.

2. Background

The Federal Communications Commission (FCC) established 18 metropolitan statistical areas (MSAs) and 12 rural statistical areas (RSAs) in California for the provision of cellular service. Within each of the 30 designated California statistical areas, the FCC issued two permits based on a lottery, thereby, creating a new duopoly telecommunications service. The FCC structured its issuance of permits so that each statistical area would have a nonwireline (Block A) carrier and a wireline (Block B) carrier.

The first applications to provide cellular service in California came from the Los Angeles MSA permit holders in 1983. Subsequently, by Decision (D.) 84-04-014, we authorized cellular carriers to set rates on what the market would bear.

With the experience of several years of cellular service in California, on November 23, 1988, we opened this investigation to assess whether the cellular radiotelephone regulatory framework established by the 1984 decision was meeting Commission objectives and if changes to the regulatory framework were warranted. To obtain maximum input into this investigation, we named as respondents all facilities-based cellular radiotelephone utilities, cellular resellers, and local exchange carriers (LECs) providing interconnection for cellular carriers.

The investigation was bifurcated. The first phase addressed generic regulatory goals. The second phase addressed specific regulatory policies for cellular wholesalers and resellers. In considering these issues, we kept in mind the continuing essential fact of this industry--a regulatory program based on the duopoly wholesale carriers licensed by the FCC.

D.90-06-025 (36 CPUC 2d 464) addressed the Phase I and Phase II issues. By that decision the cellular regulatory framework was modified to provide benefits of competition to the extent that they are achievable under the FCC's duopoly facilities-based market structure. The decision also expanded the investigation into a third phase to address the following issues that impact cellular competition:

a. A streamlined certification process for RSAs facilities-based carriers;

b. Duopoly carriers' reporting requirements that will enable us to assess and monitor on a twice-yearly basis cellular capacity utilization, capacity expansion, development of cellular services in rural areas, and prices charged for cellular services;

c. Modification of the USOA to include cost allocation methods for a carrier's wholesale and retail operations;

d. The ability of cellular resellers to perform switching functions currently provided by the cellular carriers and the unbundling of the wholesale tariff rate element; and

e. Whether a facilities-based carrier's affiliate should be prohibited from reselling in markets where the facilities-based carrier provides retail services.

3. Prehearing Conference

A prehearing conference (PHC) was held on November 1, 1990 before Administrative Law Judge (ALJ) Galvin in San Francisco. At this PHC, the Commission's Advisory and Compliance Division (CACD) was delegated the responsibility of coordinating a workshop.

The purpose of the workshop was to lessen and, if possible, to resolve the five issues remaining in the investigation.

4. Workshop Report

The workshop, held March 4 through March 8, 1991, resulted in the parties' filing of a joint workshop report on May 31, 1991. Although the workshop did not resolve the issues before us, significant progress was made in narrowing the issues.

5. Second PHC

Subsequent to receipt of the workshop report, the ALJ held a second PHC on July 19, 1991 to schedule evidentiary hearings and to establish a briefing schedule. As summarized in the joint workshop report, the parties agreed that delays in certification of RSAs were attributable primarily to the length of time required for cellular sitting and environmental reviews imposed by General Order (GO) 159 and the California Environmental Quality Act, neither of which are subjects for modification in this investigation. Further, a majority of the RSAs permit holders had already received their operating authority prior to the second PHC. Accordingly, the establishment of a streamlined certification process for RSAs facilities-based carriers became irrelevant for this proceeding.

Parties concurred that the fifth issue, whether a facilities-based carrier's affiliate should be prohibited from reselling in markets where the facilities-based carrier provides retail service, need only be addressed in briefs and that an evidentiary hearing was not necessary. Accordingly, the affiliate issue was deferred to the briefing stage of this investigation.

6. Evidentiary Hearing

Evidence on the duopoly carriers' reporting requirements and on the USOA cost allocation methods was heard August 19 through August 23, 1991. Cellular Resellers Association (CRA), Cellular Dynamics Telephone Company of Los Angeles, Inc., Cellular Dynamics Telephone Company of San Francisco, Inc., and Cellular Dynamics Telephone Company of San Diego, Inc. (jointly Cellular Dynamics), the Division of Ratepayer Advocates (DRA), PacTel Cellular Corporation and its subsidiaries (PacTel Cellular), and McCaw Cellular Communications, Inc. (McCaw) provided testimony on the reporting requirements and USOA cost allocation methods.

Evidence on the ability of cellular resellers to perform switching functions and the unbundling of the wholesale tariff rate element was heard September 30 through October 4, 1991. Witnesses for Cellular Service, Inc. (CSI), US West Cellular of California, Inc. (US West), PacTel Cellular, Los Angeles Cellular Telephone Company (LA Cellular), McCaw, and DRA testified on the reseller switch and unbundling issue.

Briefs were filed on November 7, 1991 and the proceeding was submitted upon the filing of reply briefs on December 5, 1991. However, by a March 6, 1992 ALJ ruling, submission of this investigation was set aside to address a supplemental brief and request for official notice tendered by CRA on February 12, 1992, approximately two months after this investigation was submitted. The ALJ reopened the investigation, rejected CRA's supplemental brief and request for official notice, and resubmitted the investigation effective March 6, 1992.

7. CRA's Motion for Commission Review of an ALJ Ruling

Subsequently, on March 30, 1992, CRA filed a motion for Commission review of the assigned ALJ's March 6, 1992 ruling. CRA asserted that the ALJ ruling was in legal error for two reasons: first, because judicial notice of the requested documents is mandatory under Sections 451 through 453 of the California Evidence Code, as adopted by Commission Rule 73; secondly, because the ALJ failed to make any findings of fact in his ruling. According to CRA, a long list of California Supreme Court opinions require the Commission to make separately stated findings of fact and conclusions of law on all material issues.

On April 15, 1992, GTE Mobilnet filed a reply stating that the ALJ's ruling was procedurally and substantively correct. GTE Mobilnet asserted that CRA was incorrect in that the Commission is not required to take official notice of documents. Further, GTE Mobilnet asserted that ALJs are not required to state specific findings of facts or explain the basis of their evidentiary rulings.

Subsequent to GTE Mobilnet's reply, CRA and GTE Mobilnet participated in an exchange of letters and filings regarding this matter.

Contrary to CRA's assertion, the Commission is **not required** to take official notice of documents. Rule 73 of the Commission's Rules of Practice and Procedure explicitly provides that official notice **may** be taken of such matters as **may** be judicially noticed by the courts of the State of California. Rule 73 is permissive. The documents requested for official notice, annual reports on file with the Commission, by their very nature would not be subject to mandatory judicial notice even by a court pursuant to Sec. 451 of the Evidence Code.

CRA sought to include two pages of Mobilnet's 1989 and 1990 annual report as official notice and to submit a supplemental brief after the proceeding was submitted which argued, among other matters, that Mobilnet does not currently allocate any administrative and general (A&G) costs to Mobilnet's retail operations. Although these documents were in existence at the time of the evidentiary hearing, CRA did not move to take official notice or make a motion while the proceeding was open to establish a procedure to take official notice of documents after the matter was submitted.

Official notice is generally accorded to facts and propositions of generalized knowledge that are so universally known that they cannot reasonably be the subject of dispute. However, this is not the case in this instance, as evidenced by Mobilnet's reply to CRA's request for official notice and supplemental brief. Official notice of the documents should not be taken without an explanation of how the documents were prepared, and the supplemental brief should not be allowed without affording all parties equal opportunity to submit supplemental briefs. To do otherwise will deprive other parties of their right to cross-examine or to rebut a fact that is really an issue.

Further, in its original notice filed in its appeal of the ALJ's ruling, CRA was attempting to alert the ALJ and the Commission to information on the Annual Reports which, in CRA's view demonstrated problems with use of the facilities-based carriers' proposed avoided cost methodology, as allegedly implemented by a cellular carrier. However, CRA had previously challenged the use of an avoided cost methodology in supporting applications for rehearing of D.90-06-025, and that decision stands until modified by the Commission consistent with Section 1708. Therefore, the ALJ's decision not to consider the proffered materials was consistent with D.90-06-025.

CRA's second basis for legal error is also wrong. CRA, as an active participant in Commission proceedings, should be well aware that there is no requirement that ALJ rulings include separately stated findings of fact or conclusions of law and that it is common practice, that ALJs make oral and written rulings without stating findings of fact or conclusions of law.

We affirm the ALJ's March 6, 1992 ruling.

8. Reporting Requirement

As we have discussed in D.90-06-025, id at 495 and 513, it is the proper public policy to forebear from any rate of return or profit-based regulation of cellular wholesalers (facilities-based carriers) that are pricing their services competitively. However, we would be disposed quite differently towards a facilities-based carrier that violated the public trust by withholding service to make extra profits. If such an instance occurred, we would initiate an investigation of the rates of the carrier in question and impose an appropriate and punitive constraint on its profits.

Although there was no evidence in Phase II of this investigation to convince us that such an investigation should be opened, we concluded at that time that a monitoring program should be devised to keep us apprised of market developments and to give carriers some reasonable expectations of the performance we seek. Specifically, two questions need to be answered on an ongoing basis. These questions are whether the cellular system capacity is being reasonably fully utilized and whether the cellular system is being expanded at a reasonable pace. Therefore, we concluded that this final phase of the investigation should address facilities-based carriers' reporting requirements that will enable us to attempt to assess and monitor on a twice-yearly basis cellular capacity utilization, capacity expansion, development of cellular service in rural areas, and prices charged for cellular services to answer our two questions. Since the facilities-based carriers are already required to file tariffs which identify the prices they are authorized to charge for cellular service, no additional reporting requirement on the prices charged for cellular services should be required of the facilities-based carriers. These tariffs are readily available for review and analysis at any time.

8.1 Workshop Results

At the conclusion of the workshops, all parties concurred that McCaw's proposed reporting format presented at the workshop should serve as a starting point to all cellular carriers filing reports with the Commission. The report provided for specific measurements, such as the number of cell sites in service, number of switches in service on a system-wide basis, system peak period call blocking rate, and the voice grade equivalent "RF" channels. However, CRA was opposed to McCaw's proposal to collect data on a beginning-of-period and end-of-period reporting format. CRA proposed that the carriers provide monthly data, pointing out that a report containing end of the period data or averages over a six-month period would provide an inconclusive view of the system's utilization. According to CRA, capacity utilization must be viewed over the entire six month reporting period.

The parties also concurred that cell site information should be provided in certain instances. The trigger for reporting of cell site information would be on an exception basis, i.e., only for those sites meeting specified criteria, for ten percent (10%) of the most utilized cells and 10% of the most underutilized, and for those cell cites where the quality of service has deteriorated to a level unacceptable to the Commission. The parties agreed that the Commission should establish a service quality standard for exception reporting.

In addition to the dispute as to whether carriers should report monthly data or beginning and end-of-period information in the semi-annual reporting cycle, workshop participants disagreed on the reporting of customer complaints.

8.2 Evidentiary Hearing

McCaw revised its proposed reporting requirement format at the evidentiary hearing to incorporate additional information suggested by DRA at the workshop. McCaw included measurements for the percent of peak hour calls dropped, and the number of outages and remedies. The only DRA recommendation not incorporated into McCaw's revised reporting format was tracking the number of customer complaints and responses to those complaints.

Both DRA and CRA were adamant on the need for the Commission to receive service quality complaint information in order to understand capacity and utilization measurements. Even McCaw's Kirkpatrick confirmed that degradation of service is likely to occur in an overutilized system.

CRA and Cellular Dynamics asserted that the semiannual reporting of monthly averages is necessary for the Commission to review the entire six-month reporting period for abnormalities in usage, complaints, and outages and to properly assess the facilities-based carriers' operations. CRA and Cellular Dynamics also asserted that additional detailed system-wide, switch, and cell site information from the facilities-based carriers is needed to monitor capacity utilization. CRA's Charles W. King and Harry Midgley recommended that the facilities-based carriers' first report include as much historical data as possible. King believes that this should include a three-year history of semiannual observations of markets, defined as customers, calls, and air time; prices for wholesale service; return on investment on a MSAs basis using the facilities-based carriers' current separations process; investment in facilities and equipment, and measures of utilization.

8.3 Reporting Requirement Discussion

In establishing the need for a reporting requirement in D.90-06-025, our expectation was that we would obtain answers to the following questions:

1. Whether the cellular system capacity is being fully utilized, and

2. Whether the cellular system is being expanded at a reasonable pace.

McCaw proposed certain data for our consideration. DRA and CRA, to varying degrees, differed with McCaw only in the amount of detail and frequency of data. While the proposed data discussed by the parties may be informative, we are still left far short of our primary inquiry of addressing the reasonableness of capacity utilization and pace of expansion. Instead of standards or acceptable levels of service (such as we have in General Order 133), we received recommendations for data. Assuming *arguendo* that we were to receive the data in a form proposed by one of the parties, we would still be unable to assess that data without a standard of care.

Clearly, reporting the proposed data on a routine basis is troublesome for two reasons. First, this collection of data as currently proposed could well be considered micromanagement of an industry rather than effective regulatory policymaking. Second, the collection of these data by the carriers and the review by staff would be burdensome--and may well bring us no further towards answering our initial two inquiries. Until such time that we can establish standards of reasonable system utilization and expected pace of expansion, it would be premature of us to establish a reporting requirement. The cart, unfortunately, was placed before the horse. Therefore, we will not adopt any reporting requirements at this time. However, we remind the industry that Commission staff, pursuant to PU Code § 581, is entitled to access to records on request.

9. USOA Modifications

In D.90-06-025, (id at 500-503 and 512) we informed the cellular carriers that we wanted to control potential cross-subsidy problems between a facilities-based carrier's operations and its resale operations directly. We stated that we would not impose specific margins or price limits on these carriers' retail operations. However, we would require the facilities-based carriers' retail operations to at least break even on a rational business basis. If the retail operations cover all direct costs with that business, then we can conclude that the carrier is not pricing predatorily towards the resellers, and that the cellular retail market can function like any competitive market with the customer base and earnings going to the firms that offer the best service at the lowest cost.

We concluded that the USOA would be the appropriate tool to attempt to determine the facilities-based carriers' cost to provide wholesale and retail services. However, the existing USOA was not in a form conducive to our break-even criteria. Therefore, we deferred a revision of the facilities-based carriers' USOA to incorporate cost allocation methods for the carriers' wholesale and retail operations to this phase of the investigation.

Specific guidance for the revised USOA was provided. First, cost allocation procedures should be implemented. **From a rational business perspective**, costs incurred by a carrier due to its offering of wholesale service should be properly allocated or assigned in their entirety to the wholesale side if those costs could not be avoided if the carrier discontinued retail service (id at 500-503). Secondly, sales commissions to agents should be included on the retail side unless the carrier pays them to all who deliver new customers (including resellers). To maintain a rational business perspective, the USOA should permit commissions to be amortized over the expected period of time the customer stays with the carrier. Thirdly, retail costs should include a rate of return on investments dedicated to retail service that would not be needed for wholesale-only operations.

We also informed carriers in D.90-06-025 (id) that, upon adoption of a revised USOA, facilities-based carriers would be required to report their retail revenues and expenses each six months. If retail revenues do not equal (break even) or exceed retail expenses, then the carrier will lose its ability to reduce the retail margin through temporary tariff filings.[1] If a carrier's retail expenses exceed its retail revenues for two consecutive six-month periods, then an investigation should be opened in which the carrier will have the burden of explaining why its retail operations have not been compensatory to cover operating costs.

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1 By D.90-06-025 (id at 486-493 and 516), facilities-based carriers were precluded from using a temporary tariff procedure established in that decision to reduce the current margin between wholesale and retail rates until a revised USOAs is put in place.

Carriers were also informed that compliance with the allocation methods adopted in this final phase of the investigation should be verified annually by external auditors. This auditor's opinion should be automatically filed each year with CACD within 30 days of execution, but no later than March 31 of each year.

CACD received advance notice in D.90-06-025 (id at 500-503) that CACD would be responsible for receiving the facilities-based carriers' semiannual reports, and be delegated the ministerial duty of verifying the carriers' calculations and certifying, by letter, their current status of either unrestricted temporary tariff authority or restricted temporary tariff authority. CACD would also be responsible for recommending the issuance of investigations on a facilities-based carrier that fails the cross-subsidy test.

9.1 Workshop Results

Although D.90-06-025 provided guidance in developing cost allocation methods, this topic was a major area of contention in the workshop. Key issues developed in the workshop included the definition of "avoided costs" and its applicability to accounting methodology, and how to specifically modify the current USOA.

Resellers interpreted the D.90-06-025 (id) cost allocation method[2] as costs that relate solely to wholesale service such as antennas, mobile telephone switching offices (MTSOs), and landline connection facilities.

Advocating another point of view, the facilities-based carriers' proposal allocates to the wholesale side costs that the carriers could not avoid today if they were to divest themselves of their retail operations today.

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2 Costs that the carrier must incur due to offering wholesale service are properly allocated or assigned in their entirety to the wholesale side if those costs could not be avoided if the carrier discontinued retail service.

Other key issues pertained to cost allocation methods that should be employed for commissions, advertising, customer service representatives, management information systems and billing, bad debts, sale of nonregulated services and equipment, depreciation and amortization, personnel, A&G expenses, rate of return, logos and royalties, and business acquisition costs.

Based on parties' positions regarding these issues, we received testimony on four distinct USOA modification proposals in the evidentiary phase of this proceeding. DRA submitted one plan. CRA proposed a second, which Cellular Dynamics adopted with modifications of its own. McCaw and the other facilities-based carriers jointly submitted the fourth proposal.

9.2 DRA's Position

DRA recommended that we adopt "Part 64"[3] methodology, in this final phase of the investigation, to be used to establish a detailed allocation methodology applicable to all facilities-based carriers. Part 64 is based on a fully allocated or fully distributed cost methodology whereby all costs, including overheads, are allocated to service based on the relative amount of usage.

Also, DRA recommended that a task force be comprised of representatives from the cellular carriers and DRA to develop a revised USOA, and that the task force retain the services of a consultant to implement the cost allocation principles established in this investigation. DRA believes that the cost of the task force should be funded by the cellular industry.

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3 Part 64 is a FCC cost allocation standard used by telephone corporations under FCC jurisdiction for recording transactions between regulated telephone utilities and their corporate affiliates.

DRA opposes the use of avoided cost for cost allocations per a USOA because it is not a cost accounting concept and is difficult to implement.

9.3 CRA's Position

CRA recommended specific changes to the current USOA adopted in D.86-01-043 (20 CPUC 2nd 401) for facilities-based carriers. Specifically CRA's avoided cost allocation methodology recommends that the USOA be revised to allocate all costs to wholesale that would still be incurred in their entirety by the carriers if they offered only wholesale service. Wholesale service would be assigned all investment and operating expenses associated with cellular call transmission, switching, and landline interconnection. Remaining investments in building and leasehold improvements that are used for providing both wholesale and retail service would be allocated to retail usage based on square-footage usage. Investments in vehicles, office furniture and equipment would be allocated in accordance with the relative use for wholesale and retail activities. Expense accounts would be subdivided for wholesale and retail activities, and A&G accounts would be allocated in the same proportion to wholesale and retail services as the underlying costs.

CRA's USOA modification also provides for the inclusion of a rate of return on investment dedicated to retail service, an imputed income tax charge, imputed wholesale charges to reflect the sale of wholesale cellular service by a carriers' wholesale operations to its retail operations, and the establishment of a "Royalty for Trademark Name and Logo" account to reflect an imputed charge to the facilities-based carriers' retail operations for the use of any such name and logo.

In summary, CRA's costing approach provides for costs exclusively incurred for retail operations to be assigned directly as a retail cost, costs exclusively incurred for wholesale operations to be assigned directly as a wholesale cost, and costs that are shared between retail and wholesale service apportioned according to their relative incurrence.

9.4 Cellular Dynamics' Position

Cellular Dynamics' proposal is substantially the same as CRA's. However, Cellular Dynamics recommends that, if the facilities-based carriers' proposed method is adopted, avoided costs should be defined as those costs that would have been avoided if the carrier had never instituted retail operations. Cellular Dynamics' avoided costs definition conflicts with D.90-06-025 because it relies on the premise that retail activities never existed as opposed to the decision's direction that retail activities are discontinued.

Although parties filed petitions for modification and rehearing with the Commission, and filed a petition for writ of review with the State Supreme Court, the requirement that wholesale costs be based on the assumption that retail activities have been "discontinued" was not changed. Therefore, Cellular Dynamics' avoided costs definition should not be considered in this proceeding.

9.5 McCaw and Other Facilities-Based Carriers' Position

At the workshops held prior to the evidentiary hearing on this issue, McCaw proposed that each facilities-based carrier prepare a cost allocation manual for the facilities-based carrier's individualized operation for approval by the Commission. McCaw's reasoning for separate manuals was that each facilities-based carrier conducts its business, maintains records for other than regulatory purposes, and collects statistical information based on that carrier's unique circumstances.

However, because of DRA's workshop position that uniform allocation procedures should be established, McCaw conferred with other facilities-based carriers and modified its individualized cost allocation manual to incorporate generic allocation procedures. The other facilities-based carriers support McCaw's revised cost allocation manual, hereinafter referred to as the facilities-based carriers' manual.

The facilities-based carriers' USOA manual for cost allocation procedures is based on an avoided cost standard that is quite different from CRA's. Wherever possible, costs are directly assigned. Those costs which are shared by the wholesale and retail operations, such as advertising, customer service, and billing, are allocated based on measures of activities and the application of the facilities-based carriers' definition of an avoided cost standard. The standard applied required an imputation of hypothetical costs that a carrier might incur if its existing retail customers were served by independent resellers buying wholesale service from the cellular carrier. The carriers would add these imputed costs to wholesale expenses and subtract them from retail expenses.

The facilities-based carriers' proposed USOA manual provides a number of subaccounts to provide additional detail beyond that included in the existing USOA. It also provides an assignment or allocation procedure for each USOA revenue and operating expense account.

Consistent with the current USOA, the facilities-based carriers' USOA includes accounts for noncellular activities. Noncellular activities are those operations over which the Commission does not exercise accounting jurisdiction, such as the sale or repair of customer premise equipment. Similar to the allocation of costs between wholesale and retail activities, noncellular operations' costs are directly assigned where appropriate. The remaining costs are assigned through the use of allocation mechanisms such as special analysis, activity based allocations, or based on the apportionment of previously assigned amounts.

9.6 USOA Modification Discussion

Of the 3 proposals left for analysis, DRA's is the least appropriate in this instance because it does not resolve the USOA issue and because it does not recognize that all parties were notified well in advance, by D.90-06-025 in June 1990, of our intent to modify and incorporate a cost allocation method into the facilities-based carriers' USOA in this final phase of the investigation. If DRA felt strongly enough about an industry task force to develop a revised USOA, it should have made its position known through a petition for modification shortly after D.90-06-025 was issued.

To adopt DRA's industry task force concept at this late date would require us to ignore the detailed comments and reply comments filed by interested parties prior to the workshop, the workshop process, the evidentiary hearing process, and the amount of time, effort, and money several parties, including the Commission, dedicated to this issue for more than a year. It is apparent from the results of the workshop and evidentiary hearing that additional hearings would be needed to resolve disputes that would more than likely occur within the industry task force, resulting in a substantial delay. Further, the record before us is sufficient to implement modifications to the USOA at this time.

In addition, DRA's "Part 64" concept was previously recommended by CRA in CRA's July 30, 1990 comments supporting applications for rehearing of D.90-06-025. Although some modifications to the decision were made pursuant to D.90-10-047, the avoided cost language was not changed and Part 64 was not incorporated into the decision. Consistent with D.90-06-025, by this decision we will modify the USOA.

The remaining two proposals before us are based on different interpretations of an avoided cost standard. McCaw and other facilities-based cellular carriers have suggested one version, while CRA has submitted another.

As explained at the beginning of our USOA Modification discussion, D.90-06-025, 36 CPUC 2d 464 at 500-513, sought cost allocation methods that, **from a rational business perspective,** provided for all costs a carrier must incur due to its offering of wholesale service to be allocated or assigned in their entirety to the wholesale side if those costs could not be avoided if the carrier discontinued retail service.

Parties to this proceeding have taken an inordinate amount of time attempting to determine the meaning of the phrase "avoided cost." The phrase has frequently been taken out of context, thereby obscuring our intent. In the discussion relating to the USOA in D.90-06-025, we indicated our intent to control any cross-subsidy on the part of the facilities based carriers. Avoiding cross-subsidization is a primary reason for modifying the USOA, and we will not adopt any proposal which does not meet that goal. Further, we stated that we would require a carrier's retail operations to break even on a rational business basis. If a carrier's retail operations are covering all of the costs directly associated with that business, then the carrier is not cross-subsidizing retail out of wholesale revenues or earnings. (36 CPUC 2nd at 501)

McCaw's avoided cost approach fails under the goals set forth in D.90-06-025 because it does not ensure that all of the costs directly associated with its retail operations are allocated to the retail side. Under McCaw's proposal, the costs of the facilities-based carriers' retail operation would be artificially low because it allows certain accounts that are common to both wholesale and resale to be lumped into the wholesale side.

McCaw's Kirkpatrick provided a good example of how the facilities-based carriers' avoided cost concept would be applied. If a facilities-based carrier had only one vehicle driven 60% of the time by its wholesale field engineer and driven 40% of the time by its retail manager, the cost of the vehicle and the cost to operate the vehicle should be allocated 100% to wholesale operations because, according to Kirkpatrick, the facilities-based carrier would need that vehicle for wholesale operations even if it discontinued its retail operations. But under this method, the retail operation of a facilities-based carrier would receive the benefit of the use of the vehicle without having to report it as a cost of doing business. This methodology does not meet our stated intent that the retail operation cover all costs associated with the retail business and would encourage cross-subsidy rather than prevent it.

Additionally, a carrier would not have just one vehicle, but would have a fleet of vehicles. We can use the same figures as above with a fleet, with the wholesale side utilizing the fleet 60% of the time and the retail side 40%. From a rational business perspective, if the carrier divested itself of its retail arm, it would divest itself of 40% of its fleet. Similarly, with office space, if a carrier divested itself of its retail arm, it could lease the office space utilized by the retail operations at the going market rate which would either include overheads such as building maintenance, or the lessee would be responsible for its own overheads such as building maintenance. Therefore, allocating building space, including associated overheads, based on square footage of usage will accurately reflect the true costs for both retail and wholesale operations.

The facilities-based carriers' manual is flawed in one other respect. It will not ensure standardized reporting because the manual allows for individual variations in the style and format of reporting among the carriers. The manual contains the following caveat:

> It should be noted that assignment and allocation methods described by account are provided only as examples for implementation of the Commission's avoidable cost standard. Carriers may employ different assignment and allocation methods which would also be

consistent with the commission's avoidable cost approach.

Therefore, we also reject the facilities-based carriers' plan on practical grounds. In D.90-06-025 we stated that CACD will be responsible for enforcing this monitoring requirement by receiving the periodic filings. The carriers' proposal allows for individual variations in style and format among the carriers' reports. However, common sense dictates that standardized reporting by the carriers is necessary for CACD to perform its function efficiently. Consistent filings not only allow quick and accurate comparisons to be made but also facilitate reference to common specific data. The facilities-based carriers' plan is contrary to these principles and would therefore place an unnecessary burden on this Commission's staff.

Additionally, the carriers' proposal allows the submission of estimates of many costs rather than the actual historical data. Under their plan, the facilities-based carriers would be permitted to submit data from a hypothetical model to estimate what their costs would be if they were a wholesale-only business. Yet, CACD must know the actual costs that were incurred, not hypothetical costs, if it is to successfully monitor the carriers. Analyzing recorded data is an essential element of determining compliance with Commission directives. In this regulatory scheme, we prefer to review actual historical data over hypothetical models.

CRA's proposal meets the objective for a modified USOA that we set forth in D.90-06-025 of minimizing the potential of cross-subsidies (id at 501). It also is an avoided cost allocation methodology, and thus complies with the guidelines that were set forth in D.90-06-025(id). It is not, as some have suggested, a "fully allocated costing" approach because it recognizes that the costs of certain physical facilities, such as antennas and landline connections, are assignable in their entirety to wholesale operations. This is because these facilities are investments and expenses that would be borne by a wholesale carrier, whether or not it were offering retail service. Under a fully allocated approach, however, these costs would be allocated between wholesale and retail operations.

CRA suggests that costs associated exclusively with retail operations be assigned entirely to retail business and costs exclusively incurred for wholesale operations be assigned in their entirety to wholesale. Accounts that include both retail and wholesale costs should be segregated based on their respective incurrence. By allocating costs as they were actually incurred on the wholesale and retail sides, CRA's avoided cost reporting plan minimizes the potential of cross-subsidization because it forces retail operations to accurately report their actual costs.

The McCaw witness' vehicle example described earlier illustrates this principle well. Under CRA's avoided cost methodology, if a facilities-based carrier had only one vehicle driven 60% of the time by its wholesale field engineer and driven 40% of the time by its retail manager, the cost of the vehicle and the cost to operate the vehicle would be allocated 60% to the wholesale side and 40% to retail. Thus, each side is accurately reporting what its actual cost of doing business was.

Since CRA's proposal is the only plan before us that meets the goal set forth by D.90-06-025 (id at 500-502) of an avoided cost methodology that minimizes the potential for cross-subsidization, we will adopt this proposal, Appendix B to this order, as a modification to the USOA adopted by D.86-01-043, 20 CPUC 2d 401. Our adoption of these modifications does not preclude us from making alterations at a later date should a condition warrant such a change.

Several parties have commented that there should be guidance for allocating between cellular and noncellular. Additionally, McCaw's proposed manual provided specific instructions for those allocations between cellular and non-cellular. The current USOA has provisions for allocations between cellular and noncellular, in that there are specific subaccounts for noncellular. However, guidance is not provided on how the cellular and noncellular shared revenues and expenses should be allocated. To help ensure that the carrier is not cross-subsidizing noncellular out of wholesale revenues or earnings, we will adopt guidelines for allocating between cellular and non-cellular. Any revenues and costs that can be directly assigned to cellular and noncellular should be done first. Then, any cellular and noncellular shared revenues and expenses should be allocated in the same manner prescribed for allocating between cellular wholesale and retail. However, the allocation between cellular and noncellular should take place before any further allocation between cellular wholesale and retail.

Consistent with our stated goal that the USOA be used to attempt to police predatory pricing, the USOA should, except for imputed wholesale customer revenues from a facilities-based carriers' retail operations for reselling wholesale service, reflect actual costs. The revised USOA should be applied on a consistent basis so that the specific assignment and allocation procedures distribute no more and no less than 100% of the facilities-based recorded revenues and expenses among the facilities-based carriers' noncellular, wholesale, and retail activities.

With the adoption of these modifications to the USOA, CACD can begin to attempt to efficiently monitor the cellular industry for predatory pricing. The facilities-based carriers may then utilize the temporary tariff procedure established by D.90-06-025, 36 CPUC 464 at 500-503 and 510, to reduce their retail margin upon submission of their first USOA report to CACD and acknowledgement from CACD that their retail revenues equal (break even) or exceed their retail expenses.

9.7 Rate of Return Component

In D.90-06-025, (36 CPUC 2nd at 501) we stated that the facilities-based carriers must at least break even on a rational business basis to reduce the retail-wholesale margin through temporary tariff filings. Specifically we stated that retail costs should include a rate of return on investment dedicated to retail service that would not be needed for wholesale-only operations. CRA has correctly asserted that a rate of return component is part of our required break-even analysis.

To satisfy this guideline CRA proposed that a fixed 14% rate of return, which CRA asserted is consistent with the maximum rate of return, after sharing, authorized to Pacific Bell in the incentive regulatory framework proceeding, be imputed into the break-even formula. Actually, the maximum rate of return authorized in that proceeding is 14.75%.[4]

The facilities-based carriers were quick to point out that cost of service regulation was previously found to not be appropriate for the cellular industry. However, LA Cellular conceded in its brief that it is appropriate to impose a requirement that retail rates be high enough to recover actual interest payments related to assets directly used in retail operations. LA Cellular asserted that there is no basis for imposing an arbitrary rate of return where assets have been paid for with equity dollars.

Rate of return, which is expressed as a percentage, reflects payment for the use of capital (both debt <u>and</u> equity) and is traditionally used in cost of service regulation of monopoly enterprises. However, utilizing a rate of return as a measurement

4 This absolute cap equals the benchmark rate of return (13.00%) plus half the sharable earnings between the benchmark and pre-sharing rate of return cap of 16.50% (1.75%).

for the break-even analysis as required by D.90-06-025 is not an implementation of cost-of-service regulation.

We stated in D.90-06-025 (id at 501) that a carrier is not predatorily pricing towards the resellers, if a carrier's retail operations are covering all of the costs directly associated with that business. The cost of capital (both equity and debt) is merely one of the costs of doing business.

From a rational business perspective, a firm must recover its operating expenses, including interest (payment for the use of debt capital), and taxes, as well as a payment for the use of equity capital. A competitive firm that is not engaged in predatory pricing will not only cover all of its operating costs but will also attempt to cover a normal return on its equity capital. Otherwise the owners that provide the capital to the non-predatory pricing firm will choose to invest where they can at least earn the prevailing market return on invested capital with similar risk.

Parties were put on notice by D.90-06-025 that retail costs should include a rate of return on investment dedicated to retail service that would not be needed for wholesale-only operations. During the current proceeding the parties had an opportunity to provide testimony on and cross examine CRA's witness on whether or not the maximum rate of return authorized in the incentive regulatory framework proceeding is the appropriate rate to use for the break-even analysis. However, the only rate of return proposed was by CRA. CRA's witness was not cross-examined on whether the top rate of return, after sharing, authorized to Pacific Bell in the incentive regulatory framework proceeding is appropriate, and testimony was not provided as to why this particular rate would be inappropriate other than to purport that the Commission should not adopt an arbitrary rate of return to use for the break-even analysis. Nor was this specific rate addressed in the briefs by the facilities-based carriers.

Therefore, we find that the rate proposed by CRA is reasonable, as adjusted to reflect the true cap on the rate of return after sharing as adopted in the incentive regulatory framework proceeding.

We will require, therefore, that the revised USOA adopted by this order include the break-even analysis generally as proposed by CRA. The rate of return to be used in the break-even analysis is 14.75%.

We will also require the facilities-based carriers to provide, on the USOA adopted basis, semiannual reports addressed in D.90-06-025 (id at 500-503) to CACD's Director no later than 45 days after the last day in the semiannual reporting period. These should continue to be prepared and mailed until the facilities-based carriers are notified in writing by the Executive Director that the semiannual reports no longer need to be mailed to the CACD Director. The semiannual reports should cover the periods from January 1 to June 30 and from July 1 to December 31, with the first required report to be mailed to CACD covering the period July 1, 1992 to December 31, 1992.

10. Reseller Switch

CRA proposed in the early stages of this investigation that cellular wholesale utilities be required to offer unbundled access to certificated resellers so that resellers could perform their own switching functions. Resellers asserted that such a requirement would lead to lower rates, a greater availability of innovative services, and greater competitiveness than now occurs or is likely to occur under the duopoly wholesale market structure.

However, the record developed by CRA and resellers in the prior phases of this investigation did not clearly show that CRA's reseller switch proposal was feasible. Therefore, a Commissioner's ruling issued on December 11, 1989 provided the resellers an opportunity to present a more detailed account of their reseller switch proposal in a subsequent phase of this investigation. The